

ORIGINAL

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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POSTAL RATE COMMISSION
OFFICE OF THE SECRETARY

Special Services Fees and Classifications

Docket No. MC96-3

ANSWERS OF THE OFFICE OF THE CONSUMER ADVOCATE
TO INTERROGATORIES OF UNITED STATES POSTAL SERVICE
WITNESS: ROGER SHERMAN (USPS/OCA-T100-23-36)
(NOVEMBER 6, 1996)

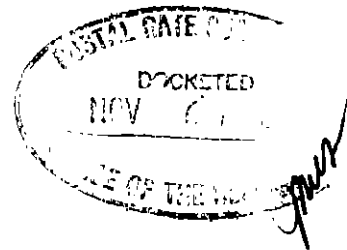
The Office of the Consumer Advocate hereby submits the answers of Roger Sherman to interrogatories USPS/OCA-T100-23-36, dated October 23, 1996. Each interrogatory is stated verbatim and is followed by the response.

Witness Sherman is out of town and his declaration will be filed later.

Respectfully submitted,

Emmett Rand Costich

EMMETT RAND COSTICH
Assistant Director
Office of the Consumer Advocate



ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-23. At page 17, lines 5 through 9 of your testimony, you compare the revenue per transaction for registry in Exhibits USPS-T-1, WP-E, page 2.

- a. Is it your understanding that the revenue per transaction figures reported in Exhibits USPS-T-5G and J are comparable with those reported in USPS-T-1, WP-E, page 2? Please explain in detail.
- b. Please explain your understanding of what is included in the registry revenues reported in the Cost and Revenue Analysis Report?
- c. Please explain your understanding of what is included in the registry revenues reported in USPS-T-1, WP-E, page 2.

A. a. At page 17, lines 5-9 of my testimony I called attention to the fact that revenue per transaction for registry is projected to increase under the new rates, based on USPS-T-5G and J. I also noted, in parentheses, that in USPS-T-1, WP-E, page 2, revenue per transaction is the same for both before and after rates. My main point was that revenue per transaction might also fall rather than increase (or even stay the same). I pointed out, however, that the effect would probably not be great because only a small part of registry would be affected. I do not know the detailed differences that would make USPS-T-5G and J differ from USPS-T-1, WP-E, page 2.

b. I assume all appropriate registry revenues are included in the audited Cost and Revenue Analysis Report.

c. I assume an estimate of 1996 registry revenues, before and after new rates, is included in USPS-T-1, WP-E, page 2.

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USPS/OCA-T100-24. At page 18, lines 7-10 of your testimony, you state your understanding "that the Postal Service historically has included return receipt revenue but not return receipt cost in the cost coverage calculation for certified mail, but that it is not doing so in this case." You then go on to state, "Perhaps Witness Patelunas used the historical practice."

- a. Please explain in detail your understanding of "the historical practice" referred to in the immediately preceding sentence.
- b. Is it your understanding that historically the Postal Service has included return receipt revenues in certified mail revenues? Please explain your understanding of what the Postal Service has historically included in certified mail revenues in detail.
- c. Is [sic] your understanding that historically the Postal Service has included return receipt costs in certified mail costs? Please explain your understanding of what the Postal Service has historically included in certified mail costs in detail.

A. a. As a fuller reading of my testimony should make clear, my understanding was drawn from Witness Needham's testimony. The first quote from my testimony that appears in the preamble to this interrogatory is part of a sentence from my page 18, lines 7-10, and the quoted part omits the source of my understanding. The whole sentence (beginning on line 6) reads: "Witness Needham reports (USPS-T-8, page 71) that the Postal Service historically has included return receipt revenue but not return receipt cost in the cost coverage calculation for certified mail, but that it is not doing so in this case." This sentence from my testimony is based on the following quote from Witness Needham (USPS-T-8, page

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CONTINUATION OF ANSWER TO USPS/OCA-T100-24:

71): "In this proceeding, the Postal Service is changing the historic practice of including return receipt revenue but not return receipt costs in the certified mail cost coverage calculation." Including return receipt revenue but not return receipt costs would clearly appear to make the certified mail cost coverage larger, so departing from this historic practice can be expected to lower the cost coverage calculated for certified mail.

In the second quote from my testimony, only the beginning of my next sentence is provided: "Perhaps witness Patelunas used the historical practice." The full sentence from my testimony reads: "Perhaps Witness Patelunas used the historical practice, because Witness Needham reports lower cost coverages, claiming the certified mail cost coverage is only 107 percent under current rates and would be 146 percent under proposed rates." I had reported earlier on that page (lines 2-5): "The cost report of Witness Patelunas (USPS-5G, 5J) shows a cost coverage for certified mail at current rates of 202.2 percent, and a cost coverage under proposed rates of 271.0 percent."

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CONTINUATION OF ANSWER TO USPS/OCA-T100-24:

b. See answer to a. My understanding comes from Witness Needham's testimony quoted there.

c. See answer to a. My understanding comes from Witness Needham's testimony, quoted in a., that return receipt revenues and costs were not consistently treated in historic certified mail cost coverage calculations.

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USPS/OCA-T100-25. At page 18, lines 15-18 of your testimony, you state, "If there is a longstanding error in the way costs have been evaluated for pricing certified mail service, that should be demonstrated and new rates might be proposed based on correct costs."

- a. Please explain what you mean by "correct costs."
- b. Please explain in detail which costs are, in your view, incorrect in this docket.

A. a. Witness Needham's testimony (USPS-T-8, page 71) indicates that an inconsistent treatment of return receipt costs and revenues has led historically to faulty cost coverages for certified mail. Correct costs would match costs with revenues to yield cost coverage calculations for certified mail that would be correct.

b. Witness Needham testified that "the historic practice of including return receipt revenue but not return receipt costs in the certified mail cost calculation" is being changed in this docket. Witness Patelunas's cost coverages for certified mail are much higher than Witness Needham's, however, leading me to wonder whether he used what Witness Needham described as the historic practice. Cost coverages in Witness Patelunas's testimony are so high that accepting them as correct would make it very difficult to argue for any price increase in certified mail. Yet a price increase has been proposed. This leads one to wonder whether the change in treatment of cost coverages is a reason for proposing a change in the certified mail rate.

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USPS/OCA-T100-26: At page 18, lines 18-20 of your testimony, you state, "At present the argument is not put explicitly and the reason for the increase -- cost increases or previously incorrect costs -- is not clear."

- a. What "argument is not put explicitly?" Please explain in detail.
- b. Please explain in detail the "cost increases" to which you are referring. Over what period of time have these "cost increases" occurred? Is it your testimony that certified mail unit costs have increased? If so, please cite the source for your conclusion.
- c. Please explain in detail the "previously incorrect costs" to which you are referring. Is it your testimony that certified mail costs have been incorrect previously? How have they been "incorrect?" For what previous periods of time have they been "incorrect?"

A. a. Changing from the historic practice of including return receipt revenue but not return receipt costs in certified mail cost coverage calculations, as described by Witness Needham (see answer to USPS/OCA-T100-24-a. above), can be expected to lower the cost coverage for certified mail. The corrected cost coverage might be a basis for requesting a price increase for certified mail. But no argument along these lines is explicitly made, showing the previous practice and why and how it is being corrected.

b. It is not clear why the Postal Service is requesting an increase in the certified mail rate. Increases in costs are often given as a reason for rate increases, usually because a revenue requirement must be greater to cover increased costs. My quoted

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CONTINUATION OF ANSWER TO USPS/OCA-T100-26:

testimony noted that the reason for a rate increase is not clear and raises the question whether cost increases are the reason or whether the new and corrected basis for calculating cost coverage is the reason.

c. See answer to USPS/OCA-T100-24, part a., above. The incorrectness is in the cost coverage calculation which Witness Needham described merely as "historic."

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USPS/OCA-T100-27. At page 23, lines 18-22 of your testimony, you refer to the "remarkable difference in processing cost between postal cards and private cards" with postal cards being "at least \$0.08 per piece less" than private cards. You cite to Exhibit USPS-T-5C at 10 for this conclusion. Is it your testimony that Exhibit USPS-T-5C at 10 reflects only processing costs? Please explain in detail.

A. I intended no special narrow meaning for the word, "processing," when I referred to the "remarkable difference in processing cost between postal cards and private cards." The attributable costs are simply much lower for postal cards, and that is the observation I intended to make.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-28. At page 23, line 22 - page 24, line 2, you discuss what you term "plausible sources" of the cost difference between postal cards and private cards mentioned in Witness Patelunas's response to interrogatory OCA/USPS-T5-11, Tr. 2/252-53. You cite to "greater compatibility of postal cards with mechanization and automation due in part to their uniform size and shape." You also mention cleaner addresses.

- a. Please confirm that in his response to interrogatory OCA/USPS-T5-11, Tr. 2/252-53, Witness Patelunas also states that it is possible "that postal cards are misidentified as private cards during data collection." If you do not confirm, please explain in detail.
- b. Do you have any basis to dispute witness Patelunas's statement that it is possible "that postal cards are misidentified as private cards during data collection." If so, please explain in detail.

A. a.-b. I did not include misidentification in the explanation I discussed because it did not seem to be a revealing explanation and can always be offered to explain peculiar results. However, if the kind of "misidentification" described by witness Patelunas is actually occurring, then the reported difference in unit costs for postal and private cards is understated, not overstated. Specifically, if data collectors are misclassifying postal cards as private cards in both the cost estimating systems and the volume estimating systems, then the reported unit cost for postal cards is basically undistorted, but the reported unit cost for private cards is too low. The only way reported unit costs for private cards could be too high and for postal cards too low is if there were inconsistent

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CONTINUATION OF ANSWER TO USPS/OCA-T100-28:

misidentification by data collectors, such as assigning costs to private cards and volumes to postal cards. This seems unlikely.

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TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-29. At page 24, lines 3-5 of your testimony, you state, "It is unfortunate that costs are not provided, to show the effects of these possible influences."

- a. By "possible influences" do you mean the uniform size and shape of postal cards?
- b. By "possible influences" do you mean the cleaner addresses of postal cards as compared to private cards?
- c. By "possible influences" do you mean the possibility of data collection misidentification?
- d. To what other "possible influences" are you referring?
- e. How would costs be "provided to show the effects of these possible influences?" Please explain in detail.
- f. Would showing "the effects of these possible influences" also include an assessment of possible data collection misidentification? If not, please explain in detail why not.

A. a. Yes, it would be useful to know how the sizes and shapes of cards would affect their costs.

b. Yes, it would be useful to know how the address quality of cards would affect their costs.

c. I did not refer specifically to data collection misidentification, but information on how it might affect costs would be useful.

d. All the possible influences I mentioned in my testimony have been noted already, so there is no other to be expected.

e. Some separate cost collection would be needed, at least on a sample basis, to determine these costs. Costs could be

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CONTINUATION OF ANSWER TO USPS/OCA-T100-29:

collected by size category and by address quality, perhaps with only two categories in each case.

f. Of course it would be useful to know how significant is data collection misidentification and what is its effect on costs.

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USPS/OCA-T100-30. At page 24, lines 8-9 of your testimony, you state, "And these effects may be stronger than is currently being assumed."

- a. By "these effects" do you mean the uniform size and shape of postal cards as compared to private cards?
- b. By "these effects" do you mean the cleaner addresses of postal cards as compared to private cards?
- c. By "these effects" do you mean the possibility of data collection misidentification.
- d. To what other "effects" are you referring?
- e. Upon what evidence do you base your statement that the effects "may be stronger than is currently being assumed?" Please explain in detail.
- f. What is your understanding of what is being "assumed?" Please explain in detail.
- g. Is it your testimony that "these effects" are currently reflected in the unit cost difference between postal cards and private cards? If not, please explain in detail. If so, how could the effects "be stronger than is currently being assumed?" Would not any "stronger" influence also be reflected in the unit cost difference between postal cards and private cards?

A. a.-d. No. The sentence immediately preceding the sentence from my testimony that is quoted in the preamble to this interrogatory is: "But it surely is uneconomic to raise the effective price of the postal card and thereby discourage the use of a Postal Service offering that costs so little to process, while at the same time encouraging the use of a service that costs more to process." It is the effects on quantities of postal and private cards noted in this immediately preceding sentence that are the "effects" of the quoted sentence, which ends a paragraph. The following paragraph explains why the effect of encouraging use of high-cost cards may be stronger than assumed.

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CONTINUATION OF ANSWER TO USPS/OCA-T100-30:

e. I base my statement that effects on postal versus private card volumes "may be stronger than is currently being assumed" on the lack of new evidence presented as to elasticities of demand for postal cards or cross-elasticities of demand between postal and private cards. (See discussion immediately following the quote in this interrogatory, from line 10 on page 24 to line 14 on page 25 of my testimony.) The response to raising the price of postal cards 10 percent to \$.22 is estimated using the extremely low elasticity of -0.17 that has been estimated for all cards as a group. It is as if that estimate was obtained when both postal and private cards experienced the same rate increase, which of course is what happened in the past. Once postal cards are separated in price from private cards it should be realized that private cards are a very close substitute, and raising the postal card price but not the private card price may lead to a greater decline in postal card volume. The demand for postal cards may be more elastic. And that would make the effects on postal versus private card volumes stronger than is currently being assumed.

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CONTINUATION OF ANSWER TO USPS/OCA-T100-30:

f. A price elasticity of demand for postal cards of -0.17 is being assumed.

g. The effects are explained in my answer to a. They concern volume responses to price changes. They can seriously affect contributions to overhead costs because of cost differences between postal and private cards. A greater decline in postal card volume than is assumed can worsen that contribution because postal cards have low attributable cost, and there may be a greater volume of private cards than is assumed, which would also worsen that contribution because private cards have higher attributable cost.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-31. At page 24, lines 17-19, you state "the possibility that more of the postal card volume will move to the very close -- and now lower priced -- substitute, private cards.

- a. What do you mean by "lower priced?" Please quantify.
- b. In making the above statement, did you take into account the cost of a [sic] purchasing a private card? Please explain in detail.
- c. What is the current average purchase price of a private card?
- d. Assume that the average purchase price of a private card is 5 cents. With postage, the total cost of purchasing and mailing a private card is 25 cents, correct?

A. a. Private cards and postal cards now bear the same price: \$.20. Under the stamped card proposal, postal cards will have a price of \$.22, while private cards will remain at the lower price of \$.20. That is what I mean when I describe private cards under the proposal as "now lower priced."

b. I take into account the changed price in postal cards, which changes the price relationship between postal and private cards. There will be a cost of buying the private card, but that has been present in the past and appears unlikely to change as a result of the stamped card proposed.

c. I have no basis for estimating the current average purchase price of a private card, but it appears unlikely to change as a result of the stamped card proposal. For anticipating changes in volumes what is important is the change in relative prices.

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CONTINUATION OF ANSWER TO USPS/OCA-T100-31:

d. I can obtain index cards that could serve as private cards for about 2 cents per card in a store. On that basis, the cost of purchasing and mailing a private card would be 22 cents. But these costs of mailing a private card will not change because of the stamped card proposal. The price of postal cards, relative to the price of private cards, will increase under the stamped card proposal, and that is what can be expected to bring about volume changes.

ANSWERS OF OCA WITNESS ROGER SHERMAN
TO INTERROGATORIES USPS/OCA-T100-23-36

USPS/OCA-T100-32. At page 27, lines 1-4 of your testimony, you indicate that the Postal Service's post office box pricing proposal did not "explicitly" consider "that there may be a cost savings in delivery to a post office box rather than to a business or residence."

- a. Is it your testimony that the Postal Service's post office box pricing proposal implicitly considered a possible cost savings in delivery to a post office box rather than to a business or residence? If so, please explain in detail.
- b. In making the statement contained in the preamble to this question, did you review and/or consider Appendix B to USPS-T-5? If so, what is your understanding of the results of Appendix B? If not, why not?
- c. Please explain in detail your understanding of the types of costs included under post office box attributable costs in the Cost and Revenue Analysis Report.
- d. In making the statement contained in the preamble to this question, did you review Exhibit USPS-T-5A? If so, what is your understanding of the types of costs included under post office box attributable costs in the Cost Segments and Components Report? If not, why not?
- e. In making the statement contained in the preamble to this question, did you review pages 34-35 of USPS-T-4? If so, what is your understanding of the types of costs included in Witness Lion's allocation of post office box attributable costs? If not, why not?
- f. In making the statement contained in the preamble to this question, did you review and/or consider the Commission's Distribution of PO Box Cost Adjustment contained in PRC-LR-2? If so, what is your understanding of the results of the Commission's Distribution of PO Box Cost Adjustment? If not, why not?
- g. If you did not review and/or consider the Commission's cost methodology as set forth in PRC-LR-1 and 2, why did you need an extension of time from September 25, 1996 to September 30, 1996 to prepare and file your testimony?

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ANSWER TO USPS/OCA-T100-32:

A. a. In setting prices for post office boxes there does not appear to be any explicit consideration of savings that might be realized by delivery through post office boxes. I know of no implicit consideration either.

b. My understanding is that Appendix B to USPS-T-5 traces consequences of the post office box rate increases. It is not a determinant of the proposed price increases, however, and I did not consider it for that reason.

c.-d. I did not use the post office box attributable costs in the Cost and Revenue Analysis Report or in the Cost Segments and Components Report (USPS-T-5A). I do not know in detail the types of costs that are included. I relied on the testimony of Witness Lion (USPS-T-4), whom I trust relied in turn on proper cost records.

e. Yes, I reviewed pages 34-35 of Witness Lion's testimony in USPS-T-4. He includes "space support," "space provision," and "all other" categories of cost, which are defined on the referenced pages. "Space provision" costs include rents, interest, and depreciation expenses, while "space support" costs include custodial and building services and supplies, maintenance (including elevators, heating and cooling), fuel, power and water,

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CONTINUATION OF ANSWER TO USPS/OCA-T100-32:

and protection activities. The "all other" category includes labor for sorting mail to boxes and supervisory activities.

f. No. I attended to Postal Service testimony and assumed it complied with Postal Rate Commission requirements.

g. I was unaware of any extension of time until early October.

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USPS/OCA-T100-33. Please refer to page 32, lines 3-4 of your testimony, where you assert "there is little doubt that alternative box services are more costly" [than post office boxes].

- a. Please explain the basis for this assertion.
- b. Assuming the existence of "economies of scope" is the reason for your assertion, please define this term and explain how it should be measured in this case.
- c. In your opinion, is there a significant difference in labor costs between CMRA employees and Postal Service employees? Please explain, in quantitative terms if possible.
- d. If labor costs at CMRAs are significantly lower, would that affect your conclusion? Please explain.

A. a. The Postal Service can deliver mail straight into post office boxes and can blend post office box services in with other postal services. CMRA's have to set up boxes at a separate location, which one would expect to be more costly. Evidence shows that CMRA's are more costly. See, for example, Witness Lion, USPS-T-4, page 22, Table 11, for CMRA rates that may be compared with proposed Postal Service rates. Witness Needham provides an explicit comparison in USPS-T-7, page 12, Table IV, which shows CMRA rates to be substantially higher than Postal Service rates.

b. Economies of scope are economies that attend the production of more than one service in a single firm. Consider a two-product example. If the cost of producing the two products is lower when they are both produced in a single firm than when each product is produced in a separate, specialized, firm, then

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CONTINUATION OF ANSWER TO USPS/OCA-T100-33:

economies of scope are said to exist. Measuring costs in these circumstances can be difficult. Essentially, what is needed in an ideal case is a reference point cost for producing only one service. Then the incremental cost of adding the second service might be estimated. Comparing that incremental cost with the cost of independently providing the second service through another firm would give an indication of the significance of economies of scope. In the Postal Service setting, one would attempt to determine the cost that the Postal Service would experience if it offered no post office boxes, versus the incremental cost of providing post office box service. The advantage this cost offers over provision by independent service providers would be a measure of economies of scope.

c. I do not know how labor costs compare between CMRA employees and Postal Service employees.

d. No. My conclusion is based largely on the evidence in testimony referred to in my answer to part a. above, not on a comparison of labor costs.

ANSWERS OF OCA WITNESS ROGER SHERMAN
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USPS/OCA-T100-34. At page 33, lines 7-9 of your testimony, you state that "the idea that delivery into a post office box costs less than delivery to a remote location is not explicitly considered."

- a. How should the Commission consider this under the criteria of the Postal Reorganization Act? Please explain in detail.
- b. How should cost of delivery to a post office box versus cost of delivery to "a remote location" be accounted for under 39 U.S.C. § 3622(b)(3)? Please explain in detail.
- c. Is it your testimony that the cost of delivery to a post office box versus the cost of delivery to "a remote location" should be accounted for under one of the non-cost criteria of the Postal Reorganization Act? If so, please specify which criterion or criteria and explain your rationale in detail.

A. a. Suppose data were presented to show that post office box delivery cost less than other means of delivery. That saving in delivery cost would essentially mean there is a lower cost of providing service through a post office box than would be calculated if that effect on delivery cost were ignored. Once the savings was converted into a reduction in post office box cost, to achieve a true rendering of that cost, pricing criteria under the Postal Reorganization Act would be applied as in any other case.

b. See answer to part a. The effect should be traced to the cost of post office box service and then the criteria can be applied.

c. No. There is no need for non-cost criteria to deal with this matter. The question involves the determination of a

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CONTINUATION OF ANSWER TO USPS/OCA-T100-34:

service's true cost. If a customer's use of a post office box lowers the cost of delivering mail, that cost savings should be taken into account in setting the post office box rate.

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USPS/OCA-T100-35. In your response to USPS/OCA-T100-11(d), you indicate that private card mailers do not "support the manufacturing costs of postal cards." Please confirm that the manufacturing costs of postal cards are covered by the 20-cent postage paid by users of the cards subclass as a whole. If you do not confirm, please explain in detail.

A. Not confirmed. For a detailed explanation, see Witness Collins' answer to USPS/OCA-T400-13, part a.

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USPS/OCA-T100-36. In your response to USPS/OCA-T100-13, you state, "I do not claim delivery cost savings attend the provision of post office box service; I suggest that there may be a savings and if so they would be worth identifying." Is it your testimony that Appendix B to USPS-T-5 does not identify delivery cost savings due to use of post office boxes? Please explain in detail.

A. I do not think Appendix B to USPS-T-5 identifies delivery cost savings in a form that can be readily converted into cost savings from post office box service in order to affect the price of that service. The savings must be imputed to the post office box units to determine effects on prices for them, and data are not presented for that pricing purpose.

DECLARATION

I, Roger Sherman, declare under penalty of perjury that the answers to interrogatories USPS/OCA-T100-23-36 of the United States Postal Service are true and correct, to the best of my knowledge, information and belief.

Executed

Nov. 8, 1996

Roger Sherman

RECEIVED
NOV 13 10 18 AM '96
POSTAL PATENT & TRADEMARK
OFFICE OF THE SECRETARY

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document upon all participants of record in this proceeding in accordance with section 3.B(3) of the special rules of practice.

Emmett Rand Costich

EMMETT RAND COSTICH
Attorney

Washington, D.C. 20268-0001
November 6, 1996